IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

MYLES STEWART, Trustee of the Estate of ARTHUR PEABODY and OLIVE PEABODY,

Appellants,

vs.

PHOENIX TITLE & TRUST COMPANY,

Appellee.

No. 18819

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF ARIZONA

REPLY BRIEF FOR THE APPELLANT STEWART

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INTRODUCTION

For the sake of clarity, the Phoenix Title & Trust Company, Inc., in its capacity as a creditor of the bankrupt estate will hereinafter be referred to as the "creditor"; the Phoenix Title & Trust Company, Inc., in its capacity as Trustee under the terms of the conveyance by the bankrupts will hereinafter be referred to as the "Trust Company"; all events transpired in Tucson, Pima County, Arizona.

OPENING STATEMENT

This brief is submitted in reply to the Brief for the Appellee in the cross appeals between the parties MYLES STEWART, Trustee of the Estate of ARTHUR PEABODY and OLIVE PEABODY, and PHOENIX TITLE & TRUST COMPANY, a creditor.

STATUTES INVOLVED

United States Bankruptcy Act:
Section 64.
Section 67.
Section 70(c).
Section 70(e).

AUTHORITIES

97 Law Ed. 32.

ARGUMENT

Comments on Cases Submitted by the Creditor

In answer to the argument of the Title Company, creditor, that the Bankruptcy Trustee cannot be subrogated to the position of the United States as a creditor under the tax lien laws, a full examination of Section 70(e)(1) and those cases cited by the Title Company, will show that such a statement is not a sound and accurate reporting of the cases cited in the brief of that party, as they relate to the case and issues before this Court.

The following comments on cases cited by the creditor are submitted for the Court's consideration.

1. *In the Matter of F. A. Whitney Carriage Company,* 173 F. Supp. 709 (Nov. 30, 1953).

This case went off on a question of State — *not* Federal — law. The Court ruled, at page 712,

> "I conclude and rule that the mortgage was within the ordinary course of trade and in the regular and usual prosecution of the corporation's business which takes it out from the Massachusetts Statute."

The comments by Sweeney, Chief Judge, in the *Whitney* case as he had ruled (page 711), that Massachusetts General Laws do not make the mortgage complained of "fraudulent," related to the power of a state to determine title to property, not to an issue of priority of recorded versus unrecorded liens.

2. *Silverman v. Wedge,* 158 N.E.2d 668 (1959).

This case is a title case, and Note No. 2 thereof is quoted as follows:

> "The statute is included in c. 63 of the General Laws which deals with excise taxes on corporations. Section 76 and predecessor statutes have always been a provision solely in aid of the collection of such taxes. The earliest form of this statute, St. 1910, c. 187, was entitled 'An Act to prohibit the sale or transfer of the assets of a corporation in fraud of the commonwealth,' and was directed to assisting the collection of taxes imposed by St. 1903, c. 437, esp. §§ 72, 74, historically predecessors of taxes now imposed by G. L. c. 63. The title of an act is to be considered in construing the act. Charles I. Hosmer, Inc. v. Commonwealth, 302 Mass. 495, 501, 19 N.E.2d 800; Rockland-Atlas Natl. Bank of Boston v. Massachusetts Bonding & Ins. Co., Mass., 157 N.E.2d 239. The title corresponded to the narrow scope of the act. It dealt with a special class of taxes and with the Commonwealth as a public body seeking to enforce its taxes. Chapter 187 and § 76 afforded no rights except to the Commonwealth. Failure

to comply with the notice provisions of § 76 gave the Commonwealth alone the power to collect from property, sold otherwise than in the ordinary course of the corporation's business, the taxes then due to the Commonwealth under c. 63. Viewed in context and in the light of its purpose, the statute merely provided to the Commonwealth a tax lien for the particular tax upon the particular property affected, which would be discharged by the payment of that tax by any person. The trustee has and had no duties to perform under the statute. He does not by his mere appointment as trustee represent the Commonwealth. No special benefit is conferred upon him by the statute.

"An amendment of § 76 by St. 1954, c. 461, § 1, changed the wording of the section in a manner which in relevant respects restated the section in language much as it had been interpreted, prior to the amendment, in the Federal case mentioned below, and as we have interpreted the earlier form of the section. See 1 Annual Survey of Mass. Law (1954) 27, 29. 11 U.S.C. (1952) § 110, sub. e(1) [11 U.S.C.A. § 110, sub. e(1)] is not applicable here.

"In a well argued bankruptcy case before the United States District Court for the District of Massachusetts, it was recognized that, even prior to the 1954 amendment, 'the purpose of the statute was . . . to give . . . a lien on property that was transferred without the proper notice' and that the section was not 'intended to cover security transactions' of the type (a mortgage) then before the court."

These above two cases cited as in support of the Title Company, creditor, are actually in support of the Bankruptcy Trustee's position.

The arguments made by the Title Company in reference to the *Sampsell* case, 9 CAA, 1946, 153 F.2d 731, and *In Re Taylorcraft Aviation Corporation,* 168

F.2d 808, are correct statements of law, *but* not applicable to the present case before the Court, and in addition, the statute in question has been amended.

These cases are *priority* cases under Section 64 of the Bankruptcy Act — not *lien* cases under Section 67. In other words, in the *Sampsell* case, "No lien claim was recorded for these taxes," (P. 733, N. 3). The "lien" discussed in this case is the type which arose "by virtue of the fact that the assessment lists of the Commissioner of Internal Revenue." This is true in the *Taylorcraft* case. This is not the case before the Court. In the instant case the liens were recorded in Pima County as required by law. Under present statute the assessment would be enough.

In 97 Law Ed. 32 an excellent annotation covering the question before the Court contains the following at page 47:

> "2. In bankruptcy proceedings, Par. 12, In General.
>
> "Section 64(a) of the Bankruptcy Act (11 U.S.C. § 104(a)) in five classes establishes the order or rank or various debts having priority, in advance of the payment of dividends to creditors, to be paid in full out of bankrupt estates. In the fourth class of such debts are 'taxes legally due and owing by the bankrupt to the United States or any State or any subdivision thereof'; and in the fifth class 'debts owing to any person, including the United States, who by the laws of the United States in (is) entitled to priority.'
>
> "While Rev Stat § 3466 is material in determining whether a claim of the United States is based on a debt owing to any person who by the laws of the United States is entitled to priority within the meaning of § 64(a)(5) of the Bankruptcy Act, § 3466 is inapplicable in a bankruptcy proceeding for determining the rank or order of the priority of

a claim of the United States as against the claim or interest of others in the bankrupt estate. This question of rank or order is exclusively controlled by the provisions of § 64(a) of the Bankruptcy Act. Re Knox-Powell-Stockton Co. (1939, CA9th Cal) 100 F.2d 979, 38 Am Bankr NS 766; United States v. Sampsell (1946, CA9th Cal) 153 F.2d 731; Re Taylorcraft Aviation Corp. (1948, CA6th Ohio) 168 F.2d 808; Adams v. O'Malley (1950, CA8th Neb) 182 F.2d 925, infra; Re L. E. Elliott Brokerage Co. (1942 DC Kan) 48 F. Supp. 144; Re Van Winkle (1943, DC Ky) 49 F. Supp 711, 53 Am Bankr NS 296. But see United States v. Reese (1942, CA7th Ill) 131 F.2d 466, 51 Am Bankr NS 660, infra.

"In determining the priorities under the Bankruptcy Act, Rev Stat § 3466 is not even useful by way of analogy as it sets up an all-over priority without exception, while the Bankruptcy Act has its own schedule of priorities intended to cover all situations within its terms and jurisdiction. United States v. Sampsell (1946, CA9th Cal) 153 F.2d 731.

"Under the Bankruptcy Act, as amended in 1926, debts due the United States are given priority under § 64, but lien creditors come under § 67 (11 USC § 107), and are prior in right to taxes without a lien under § 64. Id.

"The rule, established in nonbankruptcy proceedings, that an inchoate lien will not defeat the priority established by Rev Stat § 3466 is not applicable in bankruptcy proceedings. Re Knox-Powell-Stockton Co. (1939, CA9th Cal) 100 F.2d 979, 38 Am Bankr NS 766 (giving priority to prior state tax liens over a tax claim of the United States); United States v. Sampsell (1946, CA9th Cal) 153 F.2d 731 (holding that the United States was not entitled to priority in payment for gasoline taxes out of a bankrupt's estate, over a state's claim for franchise taxes and a mortgagee's claim for interest and attorney's fees relating to its mortgage).

"Under § 64(a) of the Bankruptcy Act inchoate tax liens in favor of the United States (for withholding and social security taxes) were held to be on a parity with inchoate county tax liens (for personal property taxes), and Rev Stat § 3466, was held not to be applicable so as to give the federal liens priority over the county liens, in Adams v. O'Malley (1950, CA8th Neb) 182 F.2d 925. At the time of the adjudication, the property of the bankrupt was subject to liens for unpaid personal property taxes levied by the county by virtue of state law, and to liens for unpaid federal taxes by virtue of federal law. Neither the state nor the United States had at that time foreclosed its liens or levied upon any specific property of the bankrupt. The decision was rested on the ground that the Bankruptcy Act provides a complete and exclusive system for administering and distributing the estates of bankrupts, and that under § 64(a) of the Bankruptcy Act taxes legally due and owing by the bankrupt to the United States and taxes due to any state or any subdivision thereof are on a parity. The question as to whether the United States should be given priority because its liens were specific and perfected, while those of the county were general and inchoate, was left open as unnecessary to determine, since the statutory liens of the county were no more general and inchoate than were the liens of the United States; and, if a seizure was a prerequisite to the perfection of the county's liens, they were held perfected after bankruptcy by the filing of notice with the court as permitted by § 67(b) of the Bankruptcy Act (11 USC § 107(b)).

"Inconsistent with the authorities referred to above is United States v. Reese (1942, CA7th Ill) 131 F.2d 466, 51 Am Bankr NS 660, where, without considering the effect of the priority provisions of the Bankruptcy Act, the court relied upon Rev Stat § 3466 in support of its holding that a federal tax lien had priority in bankruptcy proceedings

over a state's statutory lien upon real estate for taxes due thereon. In United States v. Sampsell (1946, CA9th Cal) 153 F.2d 731, it was pointed out that United States v. Reese (F) supra, was not controlling because there was a failure in that case to consider the applicable provisions of the Bankruptcy Act and also because that case relied upon authorities which are inapplicable under the Bankruptcy Act."

It is contended by the Title Company that a "Federal tax lien in bankruptcy is nothing more than a general inchoate lien." This may be a correct statement of the law where no recording of the lien has been made. It is plainly incorrect and ridiculous where the lien was recorded prior to adjudication. Again it is pointed out that the statute was amended, and such a lien is valid and subsisting after the assessment list is prepared.

Comments on
"Equity of the Case"

These comments are made in light of what the writer of this brief feels the Ninth Circuit Court considered in the case of *Pacific Finance v. Edwards,* 304 F.2d 224, 9th CAA (1962).

The Ninth Circuit Court appeared to be troubled in the *Pacific Finance Company* case with an attempt by a Trustee to invalidate a "security interest for the benefit of general creditors," which creditors could not attack the transaction the Trustee sought to set aside, and which creditors did not in fact exist. This is *not the situation* before the Court at the present time.

It is interesting to note that the general creditors, most of whom have sought judgment (see pages 4 through 6 of the Appellant Phoenix Title & Trust Company's Opening Brief for a list of creditors and the

dates of their judgments), were in the construction business and furnished materials and labor to the bankrupt for use in connection with the real property in question. It is reasonable to assume that if these general creditors knew of the "secret lien" of the *creditor*, Phoenix Title & Trust Company, these general creditors would have taken steps to protect themselves, or avoid doing business with the bankrupts on any basis.

To allow the general creditors, such as the class of persons who lent money, furnished materials, and generally dealt with the bankrupts, to be deprived of the assets which the Trustee seeks to recover in this action would be an inequity upon the general creditors and not upon Phoenix Title & Trust Company as a creditor.

In *Moore v. Bay*, 284 U.S. 3 (1931), the Supreme Court said that in asserting rights for general creditors, the Trustee does not invalidate "security instruments" for the sole benefit of any single creditor and the distribution of proceeds from such an action is for the distribution of all general creditors. Certainly equity is on the side of general creditors who supplied materials, lent money and supplied the bankrupt builder and developer with the necessary funds to carry on his construction project where a secret lien is trying to be enforced by Phoenix Title & Trust Company, as creditor. All that is asked of the creditor in this case is that he comply with state law in perfecting his security. This means that the creditor only had to give notice to others that certain of the bankrupts' property was subject to its lien. Only if the creditor, Phoenix Title & Trust Company, did not comply with the state laws does the Bankruptcy Act make its avoiding sections, to-wit, Section 70(c) and Section 70(e), applicable to the situations and vest rights in the Trustee in Bankruptcy. If the creditor,

Phoenix Title & Trust Company, insists upon talking about equitable principles, all the Court and that creditor has to remember is that its protection lies in its own hands, and all the creditor had to do was record the Collateral Assignment of the Beneficial Interest from Peabodys to Phoenix Title & Trust Company.

In this particular case it is pointed out again that the Trustee does not need to reach back to a point of time before the time of bankruptcy to invalidate the "security transaction" between Phoenix Title & Trust, as creditor, and the Peabodys under Section 70(c) of the Bankruptcy Act, because the transaction was never altered at a later date by Phoenix Title & Trust Company, as creditor, recording the security instrument, to-wit, the Collateral Assignment of Beneficial Interest.

Even without the authorities of Section 70(c) and Section 70(e) of the United States Bankruptcy Act, the transaction between Phoenix Title & Trust Company, as creditor, and the bankrupt Peabodys was void as to subsequent creditors for the reasons that the "security instrument" of Phoenix Title & Trust Company, a creditor, was never recorded and there was no notice to general creditors.

CONCLUSION

It is therefore respectfully submitted that the decision of the United States District Judge should be confirmed under Section 70(e) of the Bankruptcy Act, and the State laws of Arizona, in addition to the Court's given reasons under Section 70(c) of the Bankruptcy Act.

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APPENDIX

United States Bankruptcy Act:

Section 70(c).

The Trustee may have the benefit of all defenses available to the bankrupt as against third persons, including statutes of limitation, statutes of frauds, usury, and other personal defenses; and a waiver of any such defense by the bankrupt after bankruptcy shall not bind the trustee. The trustee, as to all property, whether or not coming into possession or control of the court, upon which a creditor of the bankrupt could have obtained a lien by legal or equitable proceedings at the date of bankruptcy, shall be deemed vested as of such date with all the rights, remedies, and powers of a creditor then holding a lien thereon by such proceedings, whether or not such a creditor actually exists.

Section 70(e).

(1) A transfer made or suffered or obligation incurred by a debtor adjudged a bankrupt under this Act which, under any Federal or State law applicable thereto, is fraudulent as against or voidable for any other reason by any creditor of the debtor, having a claim provable under this Act, shall be null and void as against the trustee of such debtor.

(2) All property of the debtor affected by any such transfer shall be and remain a part of his assets and estate, discharged and released from such transfer and shall pass to, and every such transfer or obligation shall be avoided by, the trustee for the benefit of the estate: *Provided, however*, That the court may on due notice order such transfer or obligation to be preserved for the benefit of the estate and in such event the trustee shall succeed to and may enforce the rights of such transferee or obligee. The trustee shall reclaim and recover such property or collect its

value from and avoid such transfer or obligation against whoever may hold or have received it, except a person as to whom the transfer or obligation specified in paragraph (1) of this subdivision e is valid under applicable Federal or State laws.

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

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